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New world order: planning for the transition to new breach reporting regime

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With 1 October 2021 fast approaching, Australian financial services and credit licensees are no doubt racing to uplift their existing breach reporting frameworks and design new policies and procedures aimed at alleviating the burden of the Federal Government's bold new breach reporting regime.

So, what will be the practical pressure points for licensees and what is the likely impact on enforcement?

It is well known that the Federal Government is in the process of implementing a stringent and prescriptive new regime for breach reporting for both Australian financial services licensees (AFSL) and Australian credit licensees (ACL) holders (Licensees),[1] in light of the findings of the Hayne Royal Commission (New Reporting Regime).[2] Helpfully, the Australian Securities and Investments Corporation (ASIC) Enforcement Review Taskforce has identified that the objectives of the New Reporting Regime will be to:

- clarify and strengthen breach reporting for financial services licensees under the Corporations Act 2001 (Cth) and
- for the first time, introduce a comparable breach reporting regime for credit licensees under the National Consumer Credit Protection Act 2009 (Cth)[3]

Summary of changes under New Reporting Regime

In summary, the critical changes will be:

- an expansion of the number and type of events that need to be reported. This will include investigations regarding whether a significant breach of a "Core Obligation" has occurred and the investigation is ongoing for more than 30 days
- an extension of the breach reporting window from 10 to 30 days
- a new requirement on ASIC to publish data about breach reporting and
- a requirement for licensees to "dob" in financial advisors whose businesses raise serious compliance concerns

What are "Core Obligations" and why are they important?

A reportable situation will arise if a Licensee:

- breaches or considers it likely that they will no longer be able to comply with a Core Obligation and
- the breach is, or will be, significant

Accordingly, an essential consideration for Licensees will now be whether the event or issue involves a possible breach of a Core Obligation.

While the term Core Obligation is new, in effect, the obligations are the same as those covered by existing legislation and include the full range of general obligations that fall under the current breach reporting regime.

For ACL, Core Obligations will include:

- general obligations of licensees pursuant to s 47 of the National Consumer Credit Protection Act 2009 (Cth) (other than s 47(1)(d), being the obligation to comply with credit legislation) and
- obligations under s 47(1)(d) to the extent that the relevant legislation is set out in s 50A(3)(b)

The second critical consideration for a Licensee, which AFSL holders are already intimately familiar with, is an assessment of "significance". In the past AFSL holders would self-assess significance by reference to a range of factors such as the number of customers impacted, duration of the breach and the financial impact.

Under the New Reporting Regime, a breach will now be deemed significant where the event or issue relates to a possible breach that:

- constitutes a contravention of a civil penalty provision (save for those excluded by the regulations as not significant and thus not reportable). For example s 912A of the Corporations Act — the obligation to act honestly, efficiently and fairly
- constitutes a contravention of a key requirement as defined in the National Credit Code (save for those excluded by the regulations as not significant and thus not reportable)

- constitutes a contravention of s 1041H(1) of the Corporations Act (misleading or deceptive conduct) or s 12DA(1) of the Australian Securities and Investments Commission Act 2001 (Cth) (misleading or deceptive conduct in certain circumstances)
- constitutes a contravention of a provision, which is an offence that may involve imprisonment (such as knowingly providing "defective disclosure"[4] and/or
- results, or is likely to result, in material loss or damage to members or clients

It is important to note that the phrase "material loss or damage" is not defined in the legislation, so it retains its ordinary meaning and includes both financial and non-financial loss and damage. Materiality will be unique to each case and may include for example, a member or client's financial situation.

Where a breach does not fall into one of the categories above, the significance will be determined objectively, ie whether a Licensee considers that there are reasonable grounds to believe a reportable situation has arisen.

Important factors for systems uplift

Event capture

One of the key concerns raised by Licensees through the consultation period has been the likelihood that commencement of the New Reporting Regime will substantially increase the volume of breach reports requiring lodgement. With that in mind, it is more important than ever for Licensees to invest in robust and adaptable compliance systems to manage the workload.

Licensees should be particularly mindful of the following:

- *Record keeping*: licensees should ensure that systems and staff efficiently and accurately capture data relating to compliance issues arising in all areas of their business. Where a compliance issue is identified, dates and details of identification and investigation should be recorded accurately to reduce the risk of failing to comply with the New Reporting Regime.
- *Adaptability and automation*: it will always be preferable for Licensees to automate compliance processes, avoiding the risks associated with human error. Where limited by technology, Licensees should be vigilant in ensuring appropriate triggers are built into policies and procedures such that potentially reportable situations are promptly identified.

Managing event investigations

As noted above, where Licensees undertake an investigation into whether there has been or will likely be a "significant breach of a core obligation"[5] and that investigation continues for more than 30 calendar days, the Licensee will be required to lodge a report with ASIC irrespective of the outcome of that investigation, rendering any such investigation reportable on the thirty-first day. This expansion of the existing reporting regime is predicted to dramatically increase the number of events/issues required to be reported.

The Explanatory Memorandum provides Licensees and their advisors with little guidance as to what constitutes an "investigation", which is also undefined in the legislation. The Explanatory Memorandum suggests that the term is intended to retain its ordinary meaning given that the circumstances of an investigation will be unique to each Licensee. Guidance also suggests that any "information gathering" or "human effort" expended by the Licensee will likely be relevant to a determination of whether or not an "investigation" has commenced.

Accordingly, in addition to existing breach recording practices, Licensees should maintain robust processes to capture details about investigations that may commence outside the usual compliance process. For example, consideration will need to be given as to whether the investigation of a complaint lodged through internal dispute resolution or external dispute resolution complaint processes, is an investigation for the purpose of the New Reporting Regime. In those circumstances, it's important that complaint handling staff are equipped to identify:

- whether the investigations they are conducting relate to a breach or likely breach of a Core Obligation and
- there are processes in place to record and escalate the commencement and continuation of those investigations for breach reporting purposes

Maintaining compliance with other obligations

Licensees should be aware of how the increase in potentially reportable situations may affect their compliance with existing obligations, such as obligations relating to the adequacy of technical and human resources[6] and training of representatives.[7] Where unsure, Licensees should consider investing in staff training and tech uplift to support compliance with the New Reporting Regime.

Accuracy of reporting

The New Reporting Regime requires Licensees to report to ASIC via its Regulatory Portal, which went live

on 30 March 2020. The Portal requires Licensees to complete a prescriptive form:

- particularising details of the reportable situation and
- identifying the underlying obligations breached

As many AFSL holders will have already learnt, once the form is uploaded to the Portal, it cannot be amended. In the context of potential enforcement action, Licensees may be concerned about the effect of statements of fact or opinion expressed in those reports (particularly given the inability to correct errors).

Helpfully, the recent decision of the Federal Court of Australia in *Australian Prudential Regulation Authority v Kelaher*[8] (*Kelaher*) clarifies the position with respect to reliance by regulators on the content of breach reports as admissions.

In *Kelaher*, Australian Prudential Regulation Authority (APRA) alleged that two Independent Order of Odd Fellows (IOOF) Group entities, along with two of their directors contravened certain provisions of the Superannuation Industry (Supervision) Act 1993 (Cth). In making its case, APRA sought to rely on statements contained in documents prepared for the purpose of internal investigations of the alleged contraventions and self-reporting documents (such as breach reports), as admissions.

The court rejected that argument on the basis that the contents of those documents should correctly be construed as opinions or conclusions dependent on the application of a legal standard.

In her judgment, Jagot J emphasised that even if she were to have accepted that such documents constituted admissions, she would not have given them ". . . weight in the overall analysis because the issue [being whether or not a contravention occurred] is one which [she] must determine based on the evidence and consistent with principle".[9]

Her Honour also observed that such documents are the "product of hindsight analysis" and often "expressed at an unhelpfully high level of abstraction".[10] Whether a contravention occurred is a question of fact that must be determined on the basis of the knowledge that existed at the time, without the benefit of hindsight.

Consequently, despite the more prescriptive nature of the form of breach reports mandated on the ASIC Regulatory Portal, Licensees should take some comfort that to the extent those reports contain statements of facts or opinions as to the existence or nature of a potential breach, they will not be construed as admissions by the court. Regulators will still be required to prove by the requisite legal standard that a contravention occurred by reference to contemporaneous evidence.

Next steps

For AFSL holders, transitional provisions are in place to ensure there is no gap between the application of existing breach reporting obligations and the New Reporting Regime. Critically, "knowledge" of the breach will determine which provisions apply. From 1 October 2021, if an AFSL holder first knows that a breach or likely breach occurred (whether before or after 1 October 2021), the New Reporting Regime will apply.

It will be of interest to all Licensees to observe how the New Reporting Regime will impact on enforcement in the financial services sector over the coming years. One possibility is that ASIC may find itself inundated with information and lack the resources to meaningfully interrogate that information. It might also find its ability to share information with other regulators will be frustrated.

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Footnotes

1. Financial Sector Reform (Hayne Royal Commission Response) Act 2020 (Cth).
2. *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* Final report Vol 1 (4 February 2019) Recommendations 1.6, 2.8 and 7.2.
3. Explanatory Memorandum, Financial Sector Reform (Hayne Royal Commission Response) Bill 2010 (Cth) 11.1.

4. Corporations Act 2001 (Cth), s 952F.
5. Above n 1.
6. Above n 4, s 912A(1)(d).
7. Above n 4, s s 912A(1)(f).
8. *Australian Prudential Regulation Authority v Kelaher* (2019) 138 ACSR 459; [2019] FCA 1521; BC201909008.
9. Above, at [136].
10. Above.